No. 80-1109

In the Supreme Court of the United States

OCTOBER TERM, 1980

BERNARD E. TEICHGRAEBER, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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The question presented in this federal income tax case is whether petitioners were entitled to deduct their share of certain partnership losses and expenses, which they claimed for years when they were still members of the partnership, where such deductions were allowed, after audit, for years after their withdrawal from the partnership.

1. The pertinent facts may be summarized as follows: Until 1967, petitioners were partners in Thomson & McKinnon, a brokerage firm. One of the partners, petitioner Barbara Teichgraeber, died in October 1966. Another partner, petitioner Richard F. Teichgraeber, withdrew as of December 31, 1967. A third partner, petitioner Bernard E. Teichgraeber, terminated his partnership interest on April 27, 1967 (Pet. App. 3a-4a).[1] After each of the

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[1]Because of certain difficulties in reaching a settlement with the partnership, petitioner Bernard E. Teichgraeber submitted the matter

petitioners was no longer a member of the partnership, the Internal Revenue Service conducted an audit of partnership returns for 1966 and 1967 and determined that the following deductions claimed on those returns had been improperly reported (Pet. App. 5a):

Deduction	1966	1967
Interest expense incurred to carry tax exempt bonds	$145,143.74	$97,431.40
Bad debts	462,322.23	97,412.39
Travel and entertainment expense	25,780.86	33,679.35
Conversion errors		$1,343,740.00

The partnership eventually conceded the nondeductibility of all items except the $1,343,740 conversion error loss, which the partnership and the Commissioner agreed was deductible but should have been deducted in 1968 rather than 1967 (Pet. App. 6a).

Upon the conclusion of the agreement between the partnership and the Service, the Commissioner issued deficiency notices to all persons, including petitioners, who had been members of the partnership in 1966 and 1967, to reflect the disallowance of the individual partners' aliquot share of the disallowed partnership deductions. Petitioners' deficiencies totalled $97,410.09 plus a $20.00 addition to tax (Pet. App. 2a, 5a-6a).

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to arbitration in order to complete his withdrawal from the partnership. Pursuant to the arbitration order, the partnership paid him $85,423.53, an amount equal to his original $160,000.00 capital contribution less $74,576.47, which he paid back to the partnership in order to compensate it for certain losses (Pet. App. 4a-5a).

In this proceeding brought by petitioners for redetermination of deficiencies, the Tax Court upheld the Commissioner (Pet. App. 1a-16a). It ruled that petitioners could not deduct any portion of partnership expenses for years in which they were no longer partners. It also held that the interest and bad debt expenses reported on the partnership return were not deductible and that the conversion error loss reported on that return was properly deductible only in 1968. The court of appeals affirmed on the basis of the Tax Court's opinion (Pet. App. 22a-23a).

2. The decision below correctly upheld the Commissioner's disallowance of petitioners' claimed partnership losses and expenses. It is undisputed that the deficiencies at issue here derive entirely from the disallowance of certain deductions that had initially been claimed on the partnership return, and that were, in turn, reflected on petitioners' returns.[2] Petitioners do not contend that the Commissioner's disallowances were anything other than entirely proper. They argue (Pet. 5-6), however, that at the time they withdrew from the partnership, their capital accounts were allegedly reduced to reflect the losses which the partnership erroneously claimed as deductions in 1966 and 1967. Since the net amounts they realized upon their withdrawals may have reflected those disallowed deductions, petitioners urge that they should be allowed a deduction for the properly disallowed partnership expenses and losses.

But there is no evidence to show that petitioners' returned capital was reduced on the basis of a miscalculation of 1966 and 1967 net income. Moreover, even if their capital was so

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[2]Certain of the deductions claimed for the years at issue (1966 and 1967) were allowed by the Commissioner for 1968. Because petitioners were no longer partners in 1968, they could not claim any portion of those deductions on their 1968 returns. *Moore* v. *Commissioner*, 70 T.C. 1024, 1033-1034 (1978).

reduced, it is irrelevant to petitioners' tax liability. The partnership income taxed to them during the years in issue was properly apportioned to them under the partnership agreement. Nothing in the partnership agreement suggests that petitioners were not responsible for their share of partnership income or that the other members of the partnership agreed to have it allocated to them. Thus, this case is unlike the situation in *Harris* v. *Commissioner*, 61 T.C. 770 (1974), upon which petitioners rely (Pet. 17), where there was such an agreement.

Moreover, even assuming that petitioners are barred from ever recouping capital they might have received had the partnership's 1966 and 1967 expenses been properly reflected in their capital accounts at the time their interests were redeemed, it simply means petitioners agreed to take less capital than was due them. While that undoubtedly affected the tax reportable upon their withdrawal from the partnership, it has no bearing on their liability for taxes on their share of the 1966 and 1967 partnership income. Hence, petitioners' constitutional arguments (Pet. 11-16) have no merit. Petitioners are unquestionably responsible for income which they earned. As this Court stated in *United States* v. *Basye*, 410 U.S. 441, 447-448 (1973), "[p]artners are taxable on their distributive or proportionate shares of current partnership income irrespective of whether that income is actually distributed to them." *Heiner* v. *Mellon*, 304 U.S. 271 (1938); see Sections 702 and 704 of the Internal Revenue Code of 1954 (26 U.S.C.).[3]

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[3]Contrary to petitioners' argument (Pet. 20-21), neither Rev. Rul. 73-511, 1973-2 Cum. Bull. 402, clarified by Rev. Rul. 75-21, 1975-1 Cum. Bull. 367, nor Rev. Rul. 64-90, 1964-1 Cum. Bull. 226, has any bearing on this case. The first ruling deals with income which is earned but later forfeited. The year in which it is earned, it is taxable; the year forfeited, it is a loss. Here, however, both the 1966 and 1967 income was

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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earned, it was never lost or forfeited. Revenue Ruling 64-90, *supra*, is similarly inapposite. There, a partner received monies on behalf of both himself and his partners. The entire sum was taxable to him in his year of receipt, and he was later given a correlative loss deduction for the portion he paid over to his fellow partners. Here, all the 1966 and 1967 income has been taxed to the members of the partnership for those years.